

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 167 of 1983

For Approval and Signature:

Hon'ble MR.JUSTICE R.K.ABICHANDANI and  
MR.JUSTICE R.BALIA.

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1. Whether Reporters of Local Papers may be allowed to see the judgements?
  2. To be referred to the Reporter or not?
  3. Whether Their Lordships wish to see the fair copy of the judgement?
  4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder?
  5. Whether it is to be circulated to the Civil Judge?

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KAMLA COTTON COMPANY

Versus

COMMISSIONER OF INCOME TAX

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Appearance:

MR JP SHAH for Petitioner

MR M.J. THAKORE for MR MANISH R BHATT for Respondent No. 1

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CORAM : MR.JUSTICE R.K.ABICHANDANI and  
MR.JUSTICE R.BALIA.

Date of decision: 26/11/96

ORAL JUDGEMENT (Per R.K.Abichandani,J.)

The following two questions have been referred to us for our by the Income Tax Appellate Tribunal, Ahmedabad Bench "A":-

1. "Whether on the facts and in the circumstances of

the case, the Tribunal was right in law in holding that the amount of Rs. 73,582/- was not a bad and doubtful debt?"

2. "Whether on the facts and in the circumstances of the case, the finding of the Tribunal that the claim of bad and doubtful debt was premature in the asstt. year 1973-74 and the debt became bad in the asstt. year 1977-78 was perverse and/or not borne out by the evidence on record?"

The assessee, a dealer in cotton, had supplied cotton by invoice value of Rs. 73, 582/- to Ahmedabad Jupiter Spinning and Weaving Company Limited, Bombay, which transaction took place on 10.6.1971. The said Bombay Company issued two cheques dated 25.6.1971 and 26.7.1971 in the sum of Rs. 37,000/- and Rs. 36,582.61 respectively - i.e. for the total sum of Rs. 73,582.61 paise. However, these cheques were dishonoured and on 28.6.1971 the management of the said company intimated to their employees that because of the financial difficulties, the mill was to close down. The management of the Ahmedabad Jupiter Spinning and Weaving Co.Ltd., Ahmedabad and Bombay was taken over under the provisions of Section 18A of the Industries (Development and Regulation) Act, 1951 for a period of 5 years commencing from the date of publication of the notification in the official gazette. A notification was published in the Gazette of India Extraordinary Part-II Sec.3 sub-section (ii) dated December 1, 1971, page No. 3259. On 15th October, 1971 a notification came to be issued by the Government of Bombay under Sections 3 and 4 (1)(a)(iv) of the Bombay Relief Undertakings (Special Provisions) Act, 1958, declaring the said company at Bombay, to which a guarantee was provided by the State Government, to be a relief undertaking. Simultaneously, a direction was issued in relation to the said undertaking that for the period for which it continued as relief undertaking, the rights and liabilities that may have accrued before 15th October, 1971 and any remedy for the enforcement thereof shall be suspended and all proceedings relating thereto pending before any Court, Tribunal, Officer or Authority shall be stayed. In respect of the assessment year 1973-74, initially ex-parte assessment was made under Section 144 on 9th March, 1976 but by its applications dated 9th April, 1976 and 17th April, 1976, the assessee had applied for reopening the assessment, which was reopened on 19th April, 1976. In respect of the relevant period the assessee had debited an amount of Rs. 73,583/as bad debt on the ground that the Ahmedabad Jupiter Spinning and Weaving Co.Ltd., Bombay had been

taken over by the Central Government and that the amount due from the company was not recoverable. The ITO however, held that though the said company was taken over by the Central Government, it was not known whether the Government had paid any amount to the assessee and therefore, it could not be held that the said amount had become irrecoverable. The bad debt claim was therefore, disallowed and added in the total income of the relevant year.

The assessee challenged the ITO's order before the Appellate Assistant Commissioner of Income Tax, Range "A", Baroda and the Appellate Assistant Commissioner finding that the conditions of Section 36(1)(vii) of the Income Tax Act were fulfilled inasmuch as the chances of the assessee's recovering his money were almost nil, set aside the order of the ITO with a direction to allow the deduction as bad debt under the said proviso. In the process, the Appellate Assistant Commissioner observed that what was necessary under Section 36(1)(vii) of the said Act was that the assessee should have a reasonable cause to come to a belief that a debt had become bad and that such debt should be written off in the books of accounts relevant to the previous year and that such write-off should be claimed as a deduction in the income tax return of the assessee. It was noted that the total liabilities of the mill company amounted to more than 2 crores of rupees and the chances of the assessee's recovering his dues were almost nil.

The Department approached the Appellate Tribunal against the order of the Appellate Assistant Commissioner and the Tribunal, by its order dated 30.3.1979 held that the said company was taken over by the Government only on 21.12.1974 under the provisions of the Sick Textile Undertakings Nationalisation Act, 1974 and therefore, it could not be said that the debt had become bad during the accounting year. The Tribunal held on the strength of a letter dated 17.4.1976 which was written by the Central Gujarat Cotton Dealers' Association to the assessee informing the assessee that there was no chance of recovery of its dues, that the debt had become bad only in the accounting year in which the letter was received by the assessee i.e. in the Assessment Year 1977-78, but so far as the Year 1973-74 was concerned, the claim was premature. The appeal was accordingly allowed. Later on, a Review Application was made before the Tribunal pointing out certain factual errors which had crept in its order, partly due to the errors reflected in the written arguments which were submitted by the assessee. The Tribunal by its order dated 17.9.1979 directed

certain corrections to be made in its order dated 30.3.1979. These corrections will have some bearing on the merits of the matter and therefore, we may refer to them.

In paragraph 2 of its earlier order the Tribunal had observed " - it would appear that the liability of the Jupiter Company amounted to Rs. 2.35 crores and the assessee's chance of recovering the amount were bleak." This was substituted by the following:

"It would appear that the liability of the Jupiter Company was far in excess of the assets of the said company and the assessee's chance for recovering the amount was bleak."

The Tribunal also directed a correction to be made in paragraph 6 of its earlier order which has some bearing. In the earlier order it was stated: "The assessee has stated that the company was taken over on 8.1.1971 by the Maharashtra Government. We are not sure whether the date is correct. The assessee's transaction with the Jupiter Company was after 8.1.1971 and that also when the assessee was dealing with the company whose management was with the State Government. Knowing that it is being managed by the State Government the assessee had supplied the goods to the unit, so, that by itself would not be a reason for coming to the belief that nothing would be recoverable. As against this position, we find that the Jupiter Company unit was taken over by the Government only on 21.12.1974. So till it was taken over it could not have been said that the debt became bad during the accounting year." This was ordered to be substituted by the following:-

"The assessee has stated that the company was taken over on 8.1.1971 by the Maharashtra Government however, later on we were informed that the company was taken over by the Central Government and passed on to the Authorised Controller on 8.10.1971. Later, on 21.12.1974 it was taken over under the Sick Textile Undertakings (Nationalisation) Act, 1975."

This modification is material because while making the earlier order the Tribunal had proceeded on the footing that the Government had taken over the Undertaking on 8.1.1971 and in context of that date, it had proceeded to observe that the assessee had in fact dealt with the Government which had taken over the Undertaking, since the transaction had taken place on

10.6.1971. In reality, the Central Government had passed the order of take over of management on 8.10.1971 and thereafter, the company was dealt with under the provisions of the Sick Textile Undertakings (Taking over of Management) Act, 1972 on 21.12.1974. Thus, the Government came into picture only after 8.10.1971 as per the correct position. The Tribunal however, held that despite these corrections made in its earlier order it was not necessary to modify its conclusions because they had rested their conclusions on the fact that the debt had become bad only on 17.4.1976 when the assessee had received a letter from the Central Gujarat Cotton Dealers' Association that there were no chances of recovery of its dues.

Section 36(1)(vii) as it stood at the relevant time, enabled the assessee to claim deduction in respect of any amount of debt or part thereof which was established to have become a bad debt in the previous year, subject to the provisions of sub-section (2) of the Act. In context of the said provision it was held by a Division Bench of this Court in Sarangpur Cotton Manufacturing Co.Ltd. Vs. CIT Gujarat I, reported in 143 ITR 166 that when a businessman writes off an amount, there is a prima-facie evidence that the amount is irrecoverable and the Department can rebut the prima-facie inference to show that the position taken up by the assessee was not correct. It was held that the relevant test applicable in such cases was whether there was sufficient material on record to show that a decision taken by the assessee to write off the claim as bad debt was or could be demonstrated to be improper or otherwise not bonafide.

In our view, the requirement that the debt has become bad or irrecoverable did not mean that the Department can insist upon demonstrative and infallible proof that the debt had become bad. Moreover, it is not compulsory for the assessee to take legal proceedings against the debtor for recovery of the claim before writing it off as a bad debt. In our opinion, when the creditor bonafide writes off the debt as there appears no chance of its recovery in a foreseeable future or where the recovery proceedings would be so cumbersome and expensive as to outway any advantage of instituting any recovery proceedings, he discharges the onus and would be entitled to claim deduction under the said clause (vii) of Section 36(1) as it stood at the relevant time.

This approach was even reflected in the instructions issued by the Central Board of Direct Taxes

particularly in Instructions No.370 (F No.205/15/71 (A-II) dated 13.1.1972 in which it was stated that where a claim under Section 36(1)(vii) was made by the suppliers of stores etc. to sick mills that have been taken over by the Government of a Public Sector Undertaking, the Income Tax Officer should examine the claim sympathetically and try to arrive at a decision after taking into account the financial position of the mill, the chances of recovery and other relevant circumstances. In the instant case the Tribunal by correcting the mistake that it had made in the earlier order, came to a finding that the liability of the mill company was far in excess of the assets of the company and the assessee's chances for recovering the amount were bleak. This alone would have been sufficient to justify the action of the assessee in writing off the debt as a bad debt as it would satisfy the test which has been indicated in Sarangpur Cotton Mfg. Co.Ltd. (supra). The Tribunal has clearly failed to apply this test and has ignored the relevant circumstances consequently misdirecting itself to reach the final conclusion that it has reached. The record clearly establishes that the orders were issued for take over of the management of the undertaking of the said company under Section 18A of the Industrial (Development and Regulation) Act, 1951 on 8th October, 1971. It is also established that the two cheques which were issued by the company on 25.6.1971 and 26.7.1971 were dishonoured. The Notification declaring the said mill company at Bombay to be a Relief Undertaking was issued under the provisions of the Bombay Relief Undertakings (Special Provisions) Act, 1958 on 15th October, 1971 and the enforcement of any right or remedy against the said undertaking was suspended. Therefore, if the assessee had written off its claim as a bad debt in this background in the assessment year 1973-74, it can never be said that it had not acted in a bonafide manner. There was sufficient reason for the assessee to have written off the claim as a bad debt at that relevant time. From the subsequent facts which show that the recovery was almost impossible as reflected from the letter dated 17.4.1976 written by the Central Gujarat Cotton Dealers' Association as also from the finding of the Tribunal itself that the chances of recovery of the dues from the said company were bleak, it becomes clear that the assessee's action of claiming the deduction in the relevant year was perfectly justified. There was no rational basis to hold on the strength of the letter dated 17.4.1976 that the claim of the assessee had become bad debt only when that letter was written. Even prior to that letter it is clear that there was no chance of recovery of any amount by the assessee from the company

or from the Government which had taken over the company in any foreseeable future. As there appeared to be no chance of recovery of any amount in the foreseeable future, the assessee having written off the claim as a bad debt was entitled to claim deduction under Section 36(1)(vii) of the Act in the Assessment Year 1973-74.

In this view of the matter, the question No.1 referred to us is answered in the negative in favour of the assessee and the question No.2 is answered in the affirmative in favour of the assessee. This reference stands disposed of accordingly with no order as to costs.

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